No. 14606

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

FRANK M. CHICHESTER, Trustee in Bankruptcy for the Estate of KENNETH P. SCHMIDT BUILDERS, INC., Bankrupt,

Appellant,

vs.

CLARENCE E. POLIKOWSKY, WINNIFRED POLIKOWSKY, KENNETH P. SCHMIDT and MARY WILKINS SCHMIDT,

Appellees.

OPENING BRIEF OF APPELLANT.

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Jurisdictional Statement.

On July 10, 1953, an involuntary petition in bankruptcy was filed in the United States District Court for the Southern District of California, Central Division [Tr. pp. 3-7], and was immediately referred to the Honorable Reuben G. Hunt, Referee in Bankruptcy. On December 7, 1953, an order was entered adjudging Kenneth P. Schmidt Builders, Inc., a bankrupt [Tr. pp. 8-9]. The District Court thus had bankruptcy jurisdiction under the provisions of 11 U. S. C. 95, 11 U. S. C. 11, and Title 28, U. S. C. 1334.

On October 26, 1953, the Appellees here, through their attorney, Charles M. Fueller, filed their "Petition in Support of Order to Show Cause" [Tr. pp. 9-13]. Appellant, on November 10, 1953, filed his "Answer to Petition for Order to Show Cause" [Tr. pp. 14-17]. Kenneth P. Schmidt and Mary Wilkins Schmidt and the bankrupt, Kenneth P. Schmidt Builders, Inc., filed their individual answers to the order to show cause on November 12, 1953.

The petition of the Appellees sought to impress a vendor's lien on certain real property standing in the name of the bankrupt corporation, located in Pasadena, California [Tr. p. 13]. The answers of Appellant, bankrupt, Kenneth P. Schmidt and Mary Wilkins Schmidt, individually, denied that any such lien existed. There was, therefore, jurisdiction in the United States District Court over the original petition under 11 U. S. C., Section 46.

The Referee denied the petition of the Appellees and held there was no lien in their favor on the subject real property [Tr. pp. 38-45]. Thereupon, the Appellees petitioned for a review of the Referee's order [Tr. pp. 45-48], which was amended [Tr. pp. 49-56].

On review, the District Court reversed the Referee [Tr. pp. 71-74] by an order lodged August 19, 1954, and filed September 30, 1954. Appellant filed his "Notice of Appeal" on October 13, 1954. Jurisdiction is thus in this court by virtue of Title 11, U. S. C., Sections 47a and 47b, and also by 11 U. S. C., Section 48a.

Specifications of Error.

1. The District Court erred in reversing the Referee and finding as a matter of fact that the purchasers of the real property involved were Kenneth Schmidt and his wife, Mary Wilkins Schmidt, and not the bankrupt corporation [Tr. pp. 64, 65 and 68].

2. The District Court erred in reversing the Referee and finding as a matter of fact that there was such inequity in the sale transaction here involved [Tr. p. 68].

3. The District Court erred in concluding as a matter of law that Kenneth P. Schmidt and the bankrupt corporation were one and the same and that the corporate entity must be disregarded in this instance [Tr. pp. 67 and 68].

4. The District Court erred in concluding as a matter of law that the Appellees had not waived any vendor's lien on the subject real property [Tr. pp. 69 and 70].

5. The District Court erred in adjudging that the United States District Court, sitting as a court of bankruptcy, had no jurisdiction to determine the existence of a vendor's lien against real property standing of record in the name of the bankrupt corporation.

Statement of the Case.

The controversy here involves a parcel of undeveloped real property overlooking the Rose Bowl in Pasadena, California. In the summer of 1952 this property stood in the name of Clarence and Winnifred Polikowsky (hereinafter referred to as "the Polikowskys"). They were endeavoring to sell the property and had given an exclusive listing thereof to the Charles MacArthur Company [Tr. p. 154], real estate brokers in Pasadena, California.

In 1952, Kenneth P. Schmidt (hereinafter referred to as "Schmidt") was an individual active in the development and construction of tracts of homes in the Southern California area [Tr. p. 83].

Sometime in the summer of 1952, Schmidt was approached by W. W. Duncan, an individual connected with the MacArthur Company, concerning the purchase of the Polikowsky realty [Tr. pp. 81, 154]. After some dickering back and forth, Schmidt made an offer for the realty, which may be summarized as follows [Tr. pp. 84-87]: Schmidt would give $21,500 for the property providing that the cost of the development of the tract, streets, lights, and so on, did not exceed $10,000. The $21,500 would be payable by a 6% promissory note due in six months secured by deeds of trust on the subdivided lots and the houses erected on them [Tr. pp. 84 and 85]. These trust deeds were to be subordinated to construction loans secured by trust deeds on each house and lot [Tr. p. 85]. As further security, a completion bond on each house was to be given to secure the Polikowskys from the danger of mechanic's liens [Tr. p. 188]. Finally, the Polikowskys were to execute releases of their second trust deeds as each home and lot were sold and would be paid

a pro rata share of the note due them at such time [Tr. p. 85].

Estimates of the cost of development ran higher than the $10,000 figure originally anticipated and some "horse trading" resulted. The eventual consideration agreed upon was $20,000 [Tr. p. 110].

From the outset, the Polikowskys and their broker, the MacArthur Company, recognized this as an unusual deal [Tr. p. 84]. Consequently, Schmidt's business reputation was given consideration [Tr. pp. 84 and 88]. Polikowsky, himself a builder [Tr. p. 162], apparently knew of Schmidt and his previous operations and was satisfied as to his integrity [Tr. p. 88].

Shortly before escrow, Schmidt announced, apparently for the first time, to the MacArthur Company, that this deal was to be handled through Kenneth P. Schmidt Builders, Inc. (hereinafter referred to as the "bankrupt") [Tr. pp. 100, 162].

The bankrupt had been formed some years previously for the purpose of development and construction of residence "tracts." At first, Schmidt's father and brothers were interested in the corporation [Tr. p. 143], but by 1952 they had dropped out and Schmidt personally owned at least 80%, and perhaps all the shares of stock of the bankrupt [Tr. p. 144]. He was president and director and fully dominated the corporation. At the time of the subject transaction, the bankrupt was engaged in the construction of a large tract of homes in Monterey Park, California [Tr. pp. 83 and 84]. This operation was apparently to be the source of the funds with which the Polikowskys were to be paid if some hitch developed in the projected subdivision [Tr. p. 196].

The Polikowskys were apprised of the fact that their deal was to be handled through the bankrupt [Tr. p. 162] and inferentially approved the deal, because the purchase plans went forward thereafter.

Although it is not entirely clear just what happened next, apparently sometime in early October, Mr. Charles MacArthur, of the MacArthur Realty Company, went to the escrow department of the Mutual Savings and Loan Association in Pasadena and there dictated escrow instructions for the opening of a sales escrow to dispose of the Polikowsky property [Tr. p. 188]. These instructions were not produced by Appellees, perhaps because they may have been destroyed long before this litigation for reasons which will hereafter become apparent. It may be inferred, however, from the testimony of MacArthur that these instructions followed the general outlines of the sale agreement heretofore sketched [Tr. p. 188].

After the dictation of the first set of escrow instructions by MacArthur, Schmidt called MacArthur and said that the deal could not go forward on the basis originally projected. Because the subdivision of the Polikowskys' plot was not as yet accomplished, it was impossible to obtain completion bonds as originally agreed [Tr. pp. 181 and 182]. At this point, the whole deal was on the point of collapse [Tr. p. 189]. MacArthur then suggested that in lieu of the completion bonds Schmidt go on the promissory note as a co-maker [Tr. p. 189]. Schmidt understood that he was signing as a guarantor [Tr. p. 91].

On this basis, the new escrow instructions of October 30, 1952, which are Appellee's Exhibit 3, were drawn and

executed [Tr. p. 110]. These instructions recite that the property is to be taken in the name of the bankrupt and that the bankrupt will deliver in return its promissory note for $20,000. These instructions were signed by the Polikowskys, Schmidt individually and Schmidt as president of the bankrupt corporation.

But the transaction was to undergo yet one more change. Schmidt found that the provisions governing the trust deeds to be given to the Polikowskys could not be complied with [Tr. pp. 133, 185 and 188]. He informed the MacArthur Company that the sale could not go forward on the basis set forth in the escrow instructions of October 30, 1952 [Tr. p. 110]. A change was then agreed upon which was reflected in the amended escrow instructions [Tr. p. 113], which are Appellees' Exhibit 4. All references to trust deeds, subordination and release thereof, as well as completion bonds on the street improvements were stricken from the escrow [Tr. p. 113]: in their place, the Polikowskys were to receive a straight unsecured note signed by the corporation, Schmidt and his wife, Mary Wilkins Schmidt [Tr. p. 113]. This is the first time Mrs. Schmidt appeared in the deal.

On the basis of the amended escrow instructions, the sale was accomplished. The Polikowskys received a note signed by the corporation, Schmidt and his wife [Tr. p. 10]. Title to the realty was passed to the bankrupt [Tr. p. 197]. There, matters rested until these proceedings began with a petition by the Polikowskys invoking the aid of the bankruptcy court in attaching to this realty a vendor's lien.

ARGUMENT.

I.

The District Court Reversed Without Justification Findings of Fact Made by the Referee Which Were Supported by Substantial Evidence and Not Clearly Erroneous.

It is elemental that an Appellate Court will not disturb fact determinations of a lower court unless those determinations are clearly erroneous, *Oedekerk v. Muncie Gear Works, Inc.,* 179 F. 2d 821; *Moths v. United States,* 179 F. 2d 824. This rule applies to matters heard by Referees in Bankruptcy and taken on review to the United States District Court, see General Orders XLVII, 11 U. S. C. A. Foll. Sec. 53; *In re Oriel,* 23 F. 2d 409 (Aff'd 278 U. S. 358); *Forbush v. Bartley,* 78 F. 2d 805; *In re Taylor Oak Flooring Co.,* 87 Fed. Supp. 6.

In this case the Referee made certain pivotal fact determinations which Appellant contend were amply supported by the evidence and were not clearly erroneous. On review, the District Judge summarily upset these findings. This, Appellants contend, was reversible error.

A.

The Referee made his Finding of Fact III as follows [Tr. p. 40]:

> "On October 30, 1952 an escrow was opened between the Polikowskys, as sellers of the said real property, *and the bankrupt as the buyer of the same,* at the Mutual Savings and Loan Association of Pasadena * * *." (Emphasis supplied.)

This Finding is directly contradicted by the Finding of the District Court [Tr. p. 64]:

> "3. On October 30, 1952 an escrow was opened between the Polikowskys, as sellers of the real property, *and Kenneth P. Schmidt and Mary Wilkins Schmidt, as the buyers of the same.*" (Emphasis supplied.)

It should be noted immediately that the Finding by the District Court is not supported by the evidence at all. A consideration of Appellees' Exhibit 3 [Tr. p. 110] will show that the only signatories to the original escrow instructions, dated October 30, 1952, are the bankrupt corporation and Kenneth P. Schmidt, and the Polikowskys. How then could Mary Wilkins Schmidt, on October 30, 1952, be considered one of the buyers? Obviously, the Finding of the District Court on this point has no basis in fact whatsoever.

It is not until December 12, 1952 when the amended escrow instructions were signed, that Mary Wilkins Schmidt's name first appears in the transaction [Tr. pp. 113, 114]. Even taking the Appellees own Exhibits 3 and 4 on their very face the District Court finding cannot be supported.

However, there is another, more serious vice in this reversal by the District Court. The two escrow instructions [Exs. 3 and 4; Tr. pp. 110, 113 and 114] are unclear in themselves. Exhibit 3 is signed by the bankrupt and Schmidt, personally. Exhibit 4, however, is a most peculiar document as to execution. Inspection will show that the bankrupt corporation signed by Clarence E. Polikowsky and Winnifred Polikowsky. Since there has never been any contention or evidence that these two

individuals were in any way connected with this corporation it must be concluded that they signed in error. If so, what is the significance of the signatures by Schmidt and his wife, who appears for the very first time at this point? Were they signing individually? If so, what of the bankrupt corporation? Was it not consenting to the change? How could the contract, which is Exhibit 3 [Tr. p. 110], be so vitally altered without the consent of one of the parties thereto? These and other ambiguities render the true arrangement between the parties clouded.

In this state of the facts, the Referee admitted parole evidence to show what the true arrangement was and who the real parties thereto were. Of this ruling no complaint has been made on appeal. Thus, a question of fact was posed for the Referee: Who was the true purchaser of the realty involved? (See Cyc. of Fed. Proc. (3rd Ed.) Sec. 31.58, and *Pik Rapid Power Co. v. Minneapolis St. T. & S. S. M. R. Co.,* 99 F. 2d 902 (Cert. den. 305 U. S. 660).)

The evidence quite clearly showed that the purchaser was to be the corporation. Schmidt so testified [Tr. p. 89]. The escrow fees were paid by corporate check [Tr. p. 102]. Title was to be taken in the name of the corporation [see Ex. 3; Tr. pp. 110, 197]. Schmidt and his wife were on the deal merely to guarantee payment of the note [Tr. pp. 91 and 189].

In the foregoing state of the evidence, the Referee resolved the conflicts between the ambiguous escrow instructions and the oral evidence by declaring that the corporation was the purchaser. Such was the proper Finding of Fact in view of the conflicting evidence. (Cyc.

of Fed. Proc. (3rd Ed.) Sec. 31.53; *St. Paul Fire and Marine Insurance Co. v. Bachman,* 285 U. S. 112.)

When the District Court reversed this Finding of the Referee, it transformed the entire complexion of the litigation. If Schmidt and his wife are the buyers, then, as well hereafter be seen, they occupy a position which would alter the legal effect of their individual signatures on the unsecured promissory note given in payment for the real property. If, however, the bankrupt corporation is the purchaser, then the Schmidts *vis a vis* the Polikowskys occupy quite another position.

In summary then, the Finding of the Referee that the purchaser of the real property was the corporation was a proper supported Finding of Fact, the reversal of which by the District Court was not only legally incorrect, but highly prejudicial to the Appellant here.

Closely related to the error committed in reversing of the finding of the fact of the Referee as to *who was* the purchaser *of the real property,* is that of the District Court as to the manner in which the escrows were handled.

The Referee found as follows [Tr. p. 41]:

> "After October 20, 1953, it appearing that the transaction could not be completed upon the basis above mentioned, *the Polikowskys and the bankrupt corporation amended on December 5, 1952, the said escrow instructions* * * *." (Emphasis supplied.)

In direct contradiction to the Referee's Finding of Fact, the District Judge has found as follows [Tr. p. 65]:

> "That thereafter, it appearing that the transaction could not be completed on the basis above mentioned, *the Polikowskys and Kenneth P. Schmidt and Mary*

*Wilkins Schmidt amended the purchase agreement on December 5, 1952 * * *.*" (Emphasis supplied.)

The Referee had before him at the time of the trial Appellees' Exhibits 3 and 4, the escrow instructions of October 30 and December 5, 1952, respectively [Tr. pp. 110, 113 and 114]. The bankrupt corporation signed Exhibit 3 as the buyer: Although its name was typed on Exhibit 4, the Appellees signed in a representative capacity for the bankrupt corporation—obviously an error. It was also apparent that all parties had acted as if the amended escrow instructions were fully binding on the corporation as well as on the other parties: the note was given as agreed therein, no security was demanded nor given, and titled vested in the bankrupt. To settle and clarify this matter oral testimony was admitted by the Referee and whatever conflict there was between it and Appellees' Exhibit 4 was resolved in favor of the oral testimony by the Referee's Finding IV heretofore quoted [Tr. p. 41].

What is the significance of the reversal by the District Court on this point? If the escrow instructions are amended by the Schmidts and the Polikowskys only as the District Court found, then this is a further indication that they are the "purchasers." The effect of that on the disposition of this case has been heretofore argued. If, on the other hand, the fact is as the Referee found it to be—that the amendment is between the bankrupt corporation and the Polikowskys—then this is consonant with its designation as the purchaser. The signature of Schmidt and his wife on the note then becomes what Schmidt testified it to be: a guarantee of payment for the benefit

of the Polikowskys [Tr. p. 91] and, as will hereafter appear, the Polikowskys would then have legally waived their vendor's lien.

B.

From the outset of this litigation, Appellees have strenuously urged that the corporate entity of the bankrupt should be disregarded as to them and Kenneth P. Schmidt, individually, set up in its place. Reading the transcript in its entirety will indicate that a substantial portion of the evidence introduced by the Appellees sought to establish the elements which the law recognizes as necessary if an *"alter ego"* situation is to be established.

The question of whether or not the *legal* conclusion to disregard the corporate entity made by the District Court was proper will be deferred to a subsequent portion of this brief. Here, Appellant only proposes to examine the reversal of certain Findings of Fact in connection therewith.

It seems clearly established in the California law that mere ownership of all, or a controlling interest in the stock of a corporation will not of itself permit the corporate entity to be disregarded, *Norrins Realty Co. v. Consolidated Abstract Title Co.,* 80 Cal. App. 2d 879. What is required is something in addition—that to recognize the corporate entity will promote or permit fraud, injustice or inequity, see *D. N. & E. Walter & Co. v. Zimmerman,* 214 Cal. 418; *In re Sterling,* 97 F. 2d 505 (Cert. den. 305 U. S. 629); *Hollywood Cleaning and Pressing Co. v. Hollywood Laundry Service,* 217 Cal. 124; *Gardener v. Rutherford,* 57 Cal. App. 2d 874.

Recognizing these basic rules of law, the Referee made a clear Finding of Fact on this point [Tr. p. 42]:

> "At none of the time hereinmentioned was the bankrupt corporation used or intended to be used by the said Kenneth P. Schmidt as his *alter ego* or as a device to perpetrate any fraud, injustice or equity."

That this was a proper Finding of Fact is indicated both by law and reason. The question of whether or not a fraud has been perpetrated has been declared by the Federal Courts to be one of fact. (See Cyc. of Fed. Proc. (3d Ed.) Sec. 31.53 and the many cases there cited.) If fraud is a question of fact, the same reasons would dictate that inequity and injustice be similarly classified. After all, these are relative matters, varying from case to case and, in Appellant's view, perfect examples of conclusions of ultimate fact to be drawn from all the evidentiary matters presented.

The Referee's Finding of Fact heretofore referred to was amply supported by the evidence. Nowhere has there appeared even the slightest hint that the reason Schmidt made this a corporate transaction was to work any fraud or injustice on the Polikowskys. He did all of his building operations through this corporate form, and at the very time of the negotiations was engaged in the construction of a large tract in the corporation name in Monterey Park, California [Tr. p. 196]. Because of complications in that venture, this unfortunate bankruptcy proceeding resulted. Furthermore, as an added protection to the Polikowskys, he personally went on the note as an accommodation maker. These are not the facts which indicate a misuse of the corporate form to work some sort of fraud or inequity. There is no indication any-

where in the record that Schmidt at any time attempted to hide behind the corporation shield so as to protect himself from personal liability.

In the face of the record and the Finding of Fact made by the Referee, the District Court saw fit to strike off in the opposite direction. Firstly, nothing denominated as a Finding of Fact on this essential element was made. The closest that the District Court came to this was Finding VIII [Tr. p. 67]:

> "That at all times herein mentioned the bankrupt corporation was under the control and domination of Kenneth P. Schmidt; that Schmidt was the sole stockholder; that he requested the title to said real property herein mentioned to be placed in the name of the corporation for his personal convenience; that at all times herein mentioned the employees of the Board of Directors were employees of Kenneth P. Schmidt and were appointed by him as members of the Board of Directors of said bankrupt corporation and at all times held their membership at his sufferance and subject to his dismissal at any time; that at all times mentioned herein the officers of said bankrupt corporation were employees of Kenneth P. Schmidt who held their offices at his sufferance and were subject to dismissal from their office at any time; that said Kenneth P. Schmidt commingled his funds and his real property with the funds and real property of the corporation; that the books and records of the corporation were loosely kept; that at no time prior to the filing of the bankruptcy proceedings did the real property appear upon the books of the corporation; that at the time of the transfer and prior thereto said Kenneth P. Schmidt represented the petitioners, Clarence E. and Winnifred Polikowsky, that he and the corporation were one and the same and that he was the sole owner and stockholder therein."

It will be noted that here we have no determination at all on the question of whether or not there was any fraud, inequity or injustice—the only basis for disregarding the corporate entity under the California law cited above. Instead we have a mish-mash of evidentiary facts adding up to nothing more than that the corporation was controlled and owned by Schmidt individually, which is no more than was set forth more lucidly by the Referee in his Finding of Fact No. I [Tr. p. 39].

When we turn to the Conclusions of Law made by the District Court we discover, however, the Finding of Fact, there masquerading as a determination of law [Tr. p. 68]:

> "That in this particular case *equity requires that the separate entity of the bankrupt corporation and its individual owners be disregarded* and that it be deemed for the purpose of this transaction that the transfer of said real property to said bankrupt corporation was actually a transfer of said real property to Kenneth P. Schmidt and Mary Wilkins Schmidt." (Emphasis supplied.)

While the form may be questionable, Appellant realizes that the misplacing of a Finding of Fact among the Conclusions of Law is not fatal, and where, as here, such a Finding is essential, the Conclusion of Law may be construed as a Finding of Fact to fill the gap. (*Baldwin Rubber Company v. Paine and Williams Co.,* 99 F. 2d 1; *Citizens Trust Co. v. Croll,* 289 F. 421.) The vice is not in the form, but in the substitution of the Appellate Court's determination for that of the trial court as to a question of fact.

The court here will perceive the importance of this reversal of fact if it but survey the position of the Appel-

lees. They came to the bankruptcy court to have affixed to real property standing in the name of the bankrupt corporation a vendor's lien. Almost as soon as trial began the Appellees were confronted with an embarrassing fact which has plagued them all through this litigation: Although the title stood in the name of the corporation and the promissory note given therefor was executed by the corporation, that note was also signed by Schmidt and his wife individually. They stubbornly insist (to their own personal detriment it must always be remembered) that they were asked to sign as mere guarantors. One way the Appellees sought to meet this problem was to contend that the bankrupt and Schmidt were one and the same—that the separate corporate existence should be disregarded. At least this would relieve them of the embarrassment of one signature. When the Referee, then, found no fraud, inequity or injustice he frustrated this defense and placed Appellees once more in an uncomfortable position as to Schmidt's individual signature, a position which legally, as Appellant will show hereafter, is fatal to Appellee's assertion of a vendor's lien. When the District Court summarily reversed the Finding of Fact of the Referee it removed at least one obstacle to the preferred position which the Appellees seek.

Appellant also wishes to urge upon this court that in actuality there is no evidence whatsoever to support the finding of any inequity in this instance. Mr. Polikowsky was not innocent in the construction business: he apparently was an experienced builder in the Los Angeles area [Ex. 1, Tr. p. 83; Ex. 5, Tr. pp. 159 and 162]. The fact that this was a corporate deal with title to be taken in the corporate name was known to the Polikowskys during the negotiations and before the first escrow instruc-

tions were signed [Tr. p. 81; Appellees' Ex. 5, Tr. p. 162]. An inspection of the latter letter, Appellees' Exhibit 5, is most instructive in this connection. It provides in part [Tr. p. 162]:

> "There would be no other major changes from the proposal contained in our letter of October 5th. Additional *minor items* would include:
>
> (a) *The property would be acquired in the name of Kenneth P. Schmidt Builders, Inc.* Mr. Schmidt is the president and sole owner of all the stock. *He has stated that he would be willing to personally sign the note in addition to the signature of the corporation."* (Emphasis supplied.)

It will be noted that in the opinion of the agent of the Polikowskys this is a "minor item." But further, consider the significance of the statement that "He has stated that he would be willing to personally sign the note in addition to the signature of the corporation." It can only be inferred from this that the Polikowskys' agent, MacArthur, knew and, thus, his principals the Polikowskys knew, that the corporate entity was distinct, that it alone might not be enough to protect the Polikowskys on the note, and so the additional safeguard of Schmidt's individual signature was desirable. Is this the conduct of uninformed innocence being victimized by a fraudulent, unjust or inequitable use of the corporate form? Appellant thinks not. The Polikowskys understood from the beginning that the corporation stood between them and Schmidt and that only by obtaining his individual signature could they be sure of reaching his individual assets and integrity.

To conclude, then, the Referee made a proper, vital Finding of Fact on the question of fraud, inequity and

injustice. It was amply supported by the evidence and was clearly erroneous. The District Court in complete disregard of the settled rules of Appellate law improperly reversed that Finding and made one which is contrary to at least the weight, if not all the evidence in the case.

II.

The Bankrupt Corporation Here Was a Distinct Entity Which Could Not Be Disregarded.

The Referee concluded as follows [Tr. p. 43]:

> "The bankrupt corporation is not the *alter ego* of Kenneth P. Schmidt individually, and is a separate entity distinct from Kenneth P. Schmidt, even though he owned or controlled practically all of the capital stock of the corporation and controlled and dominated its affairs."

The conclusion of the District Court [Tr. p. 68] is the opposite: namely, that the corporation was the *alter ego* of Schmidt.

As has been noted before, there is no vice under the California law in one man owning all the stock and dominating and controlling a corporation (*Norrins Realty Co. v. Consolidated Abstract Title Co.* (Op. Cit.).) Something else is required: that recognition of the corporate entity will promote fraud, injustice or inequity. Thus, the conclusion of whether or not there is an *alter ego* corporation in this case must turn entirely upon the facts.

Appellant has argued at length all the facts heretofore which indicate the justification for the Referee's Finding that there was no fraud, inequity or injustice in this instance. In the absence thereof it was error for the District Court to conclude that the bankrupt corporation and Schmidt were one and the same.

III.

The Appellees Waived Any Vendor's Lien by Conduct Inconsistent Therewith.

The District Court concluded as a matter of law that the Appellees had not waived a vendor's lien on the instant real property [Tr. p. 69]. It is the contention of the Appellant that such was error, that the correct legal conclusion from the facts, as they should have been found by the District Court (and were found by the Referee) was that a vendor's lien, if any ever did exist, was waived by the conduct of the Appellees.

A.

California Civil Code, Section 3046 provides for a vendor's lien in the following language:

> "One who sells real property has a vendor's lien thereon, independent of possession, for so much of the price as remains unpaid and unsecured otherwise than by the personal obligation of the buyer."

The California law is most clear that the vendor's lien can be waived by act and conduct inconsistent therewith, *Estate of Reed v. Reed,* 26 Cal. App. 2d 362. Such conduct may be shown by parole evidence, *Claiborne v. Castel,* 98 Cal. 30. Once waived, the vendor's lien is gone forever, *Finnell v. Finnell,* 156 Cal. 589; *Royal Consol. Mining Co. v. Royal Consol. Mines,* 157 Cal. 737.

It is clear that taking any additional security is a waiver of the vendor's lien, see *Avery v. Clark,* 87 Cal. 619; *Remington v. Higgins,* 54 Cal. 620; *Jones v. Allert,* 161 Cal. 234. While there is no California case directly in point, *Jones v. Allert* (Op. Cit.) declares that where the promissory note of a third party is taken this is such a

security as constitutes a waiver of a vendor's lien. This principle should extend to a situation where third parties signed on a promissory note given for the purchase price as accommodation makers or guarantors. Their signatures are on the instrument as security to the vendee for payment—and this is inconsistent with the vendor's lien which is predicated upon eqiutable principles of looking only to the land for security, *Ferger v. Allen,* 35 Cal. App. 738.

When these rules are applied to the facts of this case, they spell out a waiver of vendor's lien by the Appellees. The promissory note which the Appellees hold is admittedly signed not only by the corporation but also by Schmidt and his wife individually. Since they signed as makers, but without receiving personal value therefor and, as all the evidence clearly shows, for the purpose of lending their names to the bankrupt, they were accommodation makers, Cal. Civ. Code, Sec. 3110; *Bank of America v. Goldstein,* 25 Cal. App. 2d 37, 42; *Brown v. Volz,* 90 Cal. App. 2d 793.

Schmidt and his wife came to sign the note in different ways. Although there is some indication in Appellees' Exhibit 5 [Tr. p. 162] that Schmidt's individual signature was contemplated as a protection to the Polikowskys when Schmidt requested that the deal be handled through the bankrupt corporation, later testimony by MacArthur, Appellees' own witness, is to the effect that Schmidt's signature was to prevent the entire purchase falling through, and was given in lieu of completion bonds and trust deeds which were originally designed to protect the Polikowskys [Tr. p. 189]. Whichever evidence is correct, clearly Schmidt came on the note as additional security for the Polikowskys and he always so understood [Tr. p. 91].

The role of Mrs. Schmidt is not so clear. She is never mentioned in the negotiations and never appears until the amended escrow instructions of December 5, 1952, which are Appellees' Exhibit 4 [Tr. p. 113]. Her appearance then is most significant, however. By then the elaborate security structure outlined in the escrow instructions of October 30, 1952 [Tr. p. 110] had become impossible [Tr. p. 133] and there was substituted therefor the note executed by the bankrupt, Schmidt and his wife. Since, by the escrow instructions of October 30, 1952 Schmidt was already pledged to sign individually, all that was added by the subsequent instructions was the signature of Mary Wilkins Schmidt in lieu of the security provisions which had previously been outline. This had the effect of pledging her individual property as security for the payment of the note, see Cal. Civ. Code. Sec. 171 and 171b.

The conclusion, must be that at the close of the sale the Appellees accepted additional security in the form of the individual signatures of Schmidt and his wife. By so doing, the Appellees took security and waived their vendor's lien.

B.

The Referee determined that the Polikowskys waived their vendor's lien under the California law when they executed the escrow instructions of October 30, 1952 [Tr. p. 110]. In part those instructions provide:

> "* * * showing title vested in Kenneth P. Schmidt Builders, Inc., a corporation, *free of encumbrances* except: all general and special taxes for the fiscal year 1952, 1953, including personal property taxes of any former owner, and also including any special district levies, payment of which is included therein and collected therewith; all taxes and assessments levied

or assessed subsequent to date of these instructions; conditions, restrictions, reservations, covenant, rights, rights of way, easements and the exception of water on or under said land, now of record, if any; * * *" (Emphasis supplied.)

The case of *Edison Securities v. Ventura Guarantee Bldg. & Loan Assoc.,* 10 Cal. App. 2d 555 is squarely in point here. At page 557 and 558 of 10 Cal. App. 2d the court says:

> "The covenant that respondent's title to said land should be free and clear of all encumbrances excludes the idea that a title subject to a lien in favor of appellant was to be retained. (Royal Consol. Min. Co. v. Royal Consol. Mines Co., 157 Cal. 737, 748)".

The Referee personally examined the clerk's transcript in that case. He found that it contained [Tr. p. 30] an agreement similar to the one involved in the escrow in this case.

Since this court is bound by the substantive law of the State of California, Appellant urges that the *Edison Securities Company* case is determinative here and precludes any vendor's lien in favor of the Appellees. The rule of the *Edison Securities* case will indicate that they had waived their rights to any such lien.

C.

The waiver of a vendor's lien rests on the theory that the vendee does or says something which is inconsistent with his assertion of that lien, *Selna v. Selna,* 125 Cal. 357; *Kent v. San Francisco Sav. Union,* 130 Cal. 401; *Brown v. Kahn,* 176 Cal. 159.

The problem, so far as the Appellant has been able to determine, has not been squarely presented in Cali-

fornia, but in several other jurisdictions as early as the year 1807, a rule has been recognized that where the vendor knows that the purpose of conveying free and clear title to the vendee is to permit the vendee to encumber the land, then this constitutes a waiver of the vendee's rights, see *Brown v. Gillam,* 44 Wheat. (U. S.) 290; *Strong v. Strong,* 126 Ill. 301; *Springfield & M. R. Co. v. Stewart,* 51 Ark. 285; *Clover v. Rawlings,* 9 Smedes & N. (Miss.) 122. The most recent expression of this rule is to be found in the case of *Finlayson v. Waller,* 64 Idaho 618, where the court said:

> "It appears the conveyance of the apartment house property from appellant to the Wallers was made for the purpose of enabling them to mortgage the property so they might acquire funds to pay appellant the compensation as agreed in the contract. Such facts are inconsistent with any intentions to retain a vendor's lien, and therefore a waiver thereof. (27 R. C. L. p. 575, Sec. 318.)"

Appellant feels that on principle a similar rule should be adopted in this case. The Polikowskys could have insisted (in the customary fashion) on a trust deed on the real property to secure the purchase price. To obtain more for their land they did not do so. Instead, they entered into an arrangement which from the outset they and their agent, an experienced real estate broker, knew to be unusual and precarious [Tr. p. 84]. Instead of first trust deeds, they were to receive a completion bond and second trust deeds, which were to be subordinated to first trust deeds. The Polikowskys knew that the first

trust deeds would have to be attached to the property so that construction and development thereof might go forward and the Appellees eventually paid their higher consideration.

One by one these securities had to be relinquished, until the only manner in which the deal could go forward was to abandon all security which might appear of record, permit free and clear title to be given to the bankrupt and take back a note signed by the bankrupt, Schmidt and his wife [Tr. p. 189].

Now, once a vendor's lien is gone, it is gone forever. Appellant insists that where the Polikowskys voluntarily removed their last hold on the property they waived any vendor's lien. What could be more unfair and inconsistent than to permit the title to pass deliberately free and clear on the record, knowing that the bankrupt proposed to encumber it to build and to pay off the Polikowskys, and yet secretly insist that the property is the security for the notes that the Appellees hold?

In final summary, then, the District Court erred when it did not conclude that the vendor's lien was waived by accepting the signatures of Schmidt and his wife on the note, by entering into an escrow which promised free and clear title and finally by deliberately permitting title to pass unencumbered to the bankrupt, knowing full well that the purpose of such unencumbered title was to permit other loans to be placed on the property so that houses might be built and the Appellees paid.

IV.

The Bankruptcy Court at All Times Had Jurisdiction to Determine All Questions of Vendor's Liens in This Matter.

A point of considerable confusion to the Appellant has been the judgment of the District Court which held that the Bankruptcy Court was without jurisdiction in this matter [Tr. p. 74].

On argument, the District Judge announced that he did not believe that the Bankruptcy Court had jurisdiction in the matter and thereupon refused to permit either counsel for Appellant or Appellee here to argue any other point. It is presumed that the judgment was made in pursuance of that view.

Appellant cannot conceive of a case where the Bankruptcy Court more clearly had jurisdiction than in this instance. On at least two separate and distinct bases the Bankruptcy Court had jursidiction in this matter.

Generally speaking, Bankruptcy Courts are courts of limited jurisdiction, which is to say that they have summary jurisdiction only. They have summary jurisdiction as to all property, both real and personal in the actual or constructive possession of the Bankruptcy Court, *Matter of Midtown Construction Contracting Company,* 243 Fed. 56 (Cert. den. 245 U. S. 654). Where title stands in the name of the bankrupt to real property, the Bankruptcy Court has summary jurisdiction to adjudicate all questions of title thereto, *City of Long Beach v. Metcalf,* 103 F. 2d 483 (Cert. den. 60 S. Ct. 139).

There never has been the slightest question that title to the real property here stands in the name of the bankrupt. The Appellees petition alleges it, the escrow instructions so recite [Tr. p. 110] and the deed ran from the Polikowskys to the bankrupt. In the face of this evidence, how can it possibly be said that the Bankruptcy Court was without summary jurisdiction in this case? It had the property in its constructive possession and under the clear statutory and case law in bankruptcy had full jurisdiction to determine all right thereto, including asserted liens of every nature.

An even stronger case can be made out for jurisdiction in the Bankruptcy Court on the basis of the manner in which the proceedings arose here. These are not the usual efforts of a bankruptcy trustee to quiet title to property standing in the name of the bankrupt. These proceedings were initiated by the Appellees themselves [Tr. p. 9] who sought [Tr. pp. 12 and 13]:

> "* * * request the above-entitled court that an order to show cause be issued direct to said Kenneth P. Schmidt, Mary Wilkins Schmidt and Kenneth P. Schmidt Builders, Inc., and to Frank M. Chichester, Trustee in Bankruptcy for said Kenneth P. Schmidt Builders, Inc., directing them to show cause if any they have, why said vendor's lien should not be impressed upon said real property and why the above-entitled court should not declare that they, the said Kenneth P. Schmidt, Mary Wilkins Schmidt and Kenneth P. Schmidt Builders, Inc., have no right, title nor interest therein or why said Clarence E. Polikowsky and Winnifred Polikowsky should

not be permitted to bring an action in the courts of the State of California to impose said vendor's lien."

Now it is settled law that where a claimant or one asserting a lien voluntarily submits the question of his rights for determination to the Bankruptcy Court jurisdiction is conferred by that consent, *Hirsch v. Morton,* 13 F. 2d 701; *In re Hadden-Rodee Co.,* 135 Fed. 886.

In this case *all parties named in the order to show cause appeared and* a full trial was had on the issues. The question of jurisdiction was never mentioned nor raised by anyone. Then, for the first time the problem was raised by the District Court itself.

It can be seen from the foregoing that since the litigation here was over property in the constructive possession of the bankruptcy court, between parties *all* of whom consented to a determination of their rights by the bankruptcy court, the District Court erred in finding it was without jurisdiction in this matter.

Conclusions.

Appellant insists that there must be a reversal in this case for the following reasons:

1. Because the District Court reversed Findings of Fact made by the trial court and which were supported by the evidence and not clearly erroneous.

2. Because the District Court incorrectly concluded as a matter of law that the bankrupt corporate entity should be disregarded and considered one and the same as Kenneth P. Schmidt, individually.

3. Because the District Court incorrectly concluded that there was not a waiver of the vendor's lien in this case.

4. Because the District Court incorrectly adjudged and decreed that the Bankruptcy Court was without jurisdiction in this matter to determine the rights of the respective parties in and to the real property here involved.

Respectfully submitted,

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